Fundamentals of a Bond Sale

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Introduction

- We are batting clean-up in this session
- We will review critical terms and concepts
- We will summarize the sale process

Agenda

- Bond sale from start to finish
  - Financial elements
  - Legal elements
- Post sale considerations
- Questions and answers

Where to Begin

- Framing the goal
  - Assessing resources and needs over time
    - Capital Program
  - To bond or not to bond
    - Capital, financial and debt policies
- Assembling the team
- Seeking needed approvals

From the kick-off meeting to the closing transcript

- Everyone should have a clear handle on the credit structure of the transaction
- What are the key documents to be prepared?
- Who is responsible for each task?
- Identify the appropriate disclosure team
- Develop a realistic transaction timetable
- Take this information away from the kick-off meeting

The disclosure process

- Everything contained in the disclosure documents should be verified by someone on the financing team
  - Everything!
  - Including the footnotes!
- Craft a clear, communicative offering document
  - Consider using more “plain English”
- Remember the consequences of including information in the offering document
- The formal due diligence session

Proofread!

- There is no such thing as “boilerplate”!

Finally: the Bond Sale

- Structuring
- Marketing
- Pricing
- Closing
- Post-Closing

Key Players in A Bond Sale

- Underwriter intermediates between borrower and lender
  - Buys bonds at wholesale price from issuer
  - Re-sells to investor at profit
  - In negotiated sale, also serves as investment banker in assisting to structure transaction

The Underwriter(s)

- Senior manager "runs the books"
  - Coordinates other members
  - Allocates bonds
- Co-managers
  - Share underwriting risk
  - Have better access to bonds
- Selling group
  - Other firms invited to submit orders
- The Broker/Dealer
  - The desk (underwrites bonds)
  - The investment banker (originates and structures)

Factors Affecting Bond Prices/Interest Rates

- Talking the talk: price vs. yield
  - The higher the price, the lower the yield
- Overall interest rate environment
  - General economic conditions
  - Inflation expectations
- Supply and demand
- Taxable yield equivalent
- Security and ratings
- Secondary market liquidity

Underwriting Process

- Negotiated Sale
  - Underwriter selected up-front
  - Investment banker participates in structuring
  - Interest rates established through collaboration
  - Adjusted based on actual investor interest and orders
    - Individual maturities will be repriced based on order flow
    - Rates lowered if a maturity is “over-subscribed”
- Competitive Sale
  - Deal is structured by financial advisor
  - Request for bids advertised
  - Current practice allows reasonable flexibility
  - Bids accepted at a specific date and time
    - Most commonly via electronic platform
  - Bonds sold to bidder with lowest “true interest cost”

Advantages of Alternative Methods of Sale

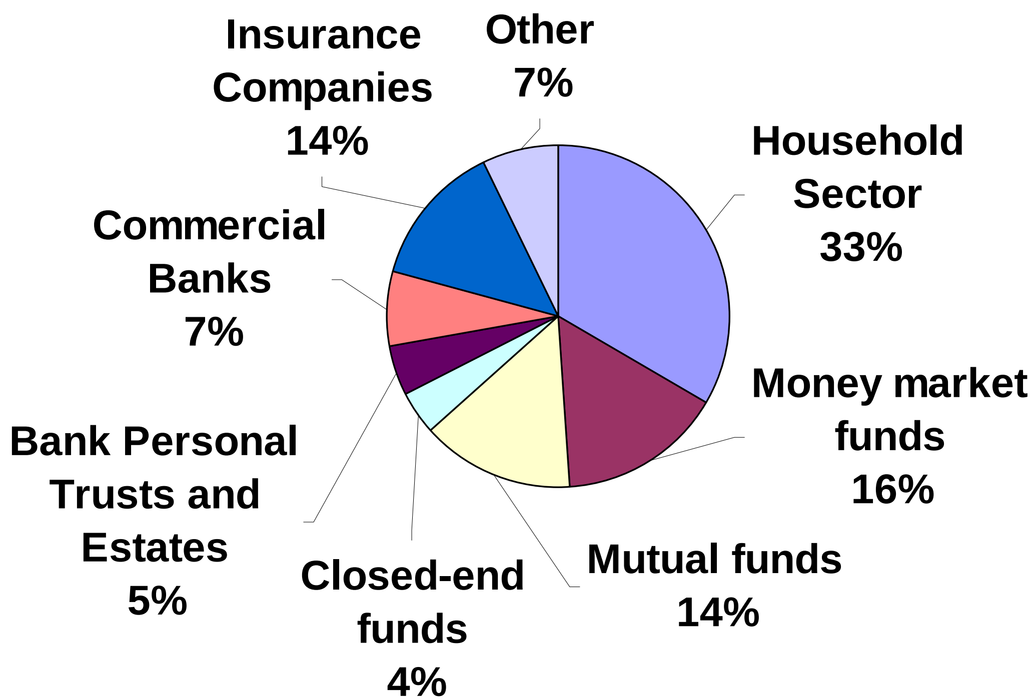
- Negotiated Sale
  - Best suited for "story bonds"
  - Allows underwriter to pre-market bonds
  - Transaction can be re-structured to meet specific investor demand
  - More flexibility in timing
- Competitive Sale
  - Emphasizes "commodity" nature of bonds
  - Satisfies public policy preference for competitive procurement
  - Sometimes legally required (but often exceptions apply)

Underwriting Compensation

- The underwriting "spread" is described as $/bond
  - A "bond" refers to $1,000 in par amount (what bonds were denominated before we were born)
- Major component of spread
  - Takedown—largest component, pays for distribution system and risk
  - Management fee—pays for investment banking (structuring) services
  - Expenses—underwriter's direct expenses built into spread
- Other costs of issuance usually paid directly by borrower
  - Bond counsel, financial advisor and rating fees
  - Bond insurance

The Investors

- Retail
  - Individual investors
  - From “mom and pop” to the wealthy individual
- Institutional
  - Mutual funds
  - Money managers
  - Insurance companies
  - Banks
  - Other corporations



From sale to closing

- Completing the sale
  - Negotiated sale: verbal award and signing the BPA
  - Competitive sale: awarding the bid
    - No BPA: Terms of sale imbedded in the notice inviting bids
- Finalizing the official statement
- Preparation of closing documents
  - Final legals (indenture, trust agreement, lease agreement, etc.)
  - Tax certificates
  - 10(b)5 certificates
  - Other closing documents
- Wiring instructions
  - Coordination with underwriter, bond insurer, trustee and DTC
- Pre-closing and closing

Beyond closing

- The closing transcript does not close out the transaction process
- Continuing disclosure may apply
- Consider when the issuer may be "speaking to the market"
- Implement a program and a process for investor relations including website updates
- Consider other ongoing requirements under the legal documents

Vocabulary
Courtesy of http://www.investinginbonds.com

- Agreement Among Underwriters (AAU): Legal document used principally in negotiated sales by underwriters. The document consists of the instructions, terms and acceptances, and the standard terms and conditions.
- allotment: Distribution of bonds to syndicate members by the book running manager.
- ascending, or positive, yield curve: The interest rate structure which exists when long-term interest rates exceed short-term interest rates.
- basis point: Smallest measure used in quoting yields on bonds and notes. One basis point is 0.01% of yield. For example, a bond's yield that changed from 6.52% to 7.19% would be said to have moved 67 basis points.

Vocabulary

- basis price: The price of a security expressed in yield, or percentage of return on the investment. Price differentials in municipal bonds are usually expressed in multiples of 5/100 of 1%, or “05."
- bond: (1) The written evidence of debt, bearing a stated rate or stated rates of interest, or stating a formula for determining that rate, and maturing on a date certain, on which date and upon presentation a fixed sum of money plus interest (usually represented by interest coupons attached to the bond) is payable to the holder or owner. A municipal bond issue is usually comprised of many bonds that mature over a period of years; (2) For purposes of computations tied in to “per bond,” a $1,000 increment of an issue (no matter what the actual denominations are); (3) Bonds are long-term securities with a maturity of greater than one year.

Vocabulary

- bond purchase agreement (BPA): The contract between the issuer and the underwriter setting forth the terms of the sale, including the price of the bonds, the interest rate or rates which the bonds are to bear and the conditions to closing. It is also called the purchase contract.
- closing date: This is similar to a settlement date, but occurs for a new issuance of bonds. The closing may be as long as 30 days in case of a competitively sold issue.
- continuing disclosure: Under amendments to Rule 15c2-12, the obligation on the issuer's part to provide annual updating of financial information and operating data of the type included in the official statement for the primary bond offering. The issuer must also provide notice of material events.
- CPO: Central Post Office (www.disclosureusa.org).

Vocabulary

- coupon: The rate of interest payable annually. Where the coupon is blank, it can indicate that the bond can be a " zero-coupon," a new issue, or that it is a variable-rate bond.
- dealer: A securities firm or department of a commercial bank that engages in the underwriting, trading and sale of municipal (or other) securities.
- discount: (1) Amount (stated in dollars or a percent) by which the selling or purchase price of a security is less than its face amount; (2) Amount by which the amount bid for an issue is less than the aggregate principal amount of that issue.
- initial offering price: The price (based upon yield to maturity) stated as a percentage of par at which the account determines to market the issue during a set period of time, called the initial offering period. Members of the account may not offer any part of the issue at any other price during that period.

Vocabulary

- manager (or senior manager): The underwriter that serves as the lead underwriter for an account. The “manager” generally negotiates the interest rate and purchase price in a negotiated transaction or serves as the generator of the consensus for the interest rate and purchase price to be bid in a competitive bidding situation. The “manager” signs the contracts on behalf of the account and generally receives either a fee or a slightly larger spread for its services in this capacity.
- mutual fund: Also known as an open-end investment company, to differentiate it from a closed-end investment company. Mutual funds invest pooled cash of many investors to meet the fund’s stated investment objective. Mutual funds stand ready to sell and redeem their shares at any time at the fund’s current net asset value: total fund assets divided by shares outstanding.

Vocabulary

- net interest cost: The traditional method of calculating bids for new issues of municipal securities. The total dollar amount of interest over the life of the bonds is adjusted by the amount of premium or discount bid, and then reduced to an average annual rate. The other method is known as the true interest cost (see also “true interest”).
- notice of sale: An official document disseminated by an issuer of municipal securities in a competitive bond sale that gives pertinent information regarding an upcoming bond issue and invites bids from prospective underwriters.
- NRMSIR: Nationally recognized municipal securities information repository.
- par: Price equal to the face amount of a security; 100%.
- par amount: The principal amount of a bond or note due at maturity. Also known as par value.

Vocabulary

- point: Shorthand reference to 1%. In the context of a “bond,” a “point” means $10, since a “bond” with this reference means $1,000 (no matter what the actual denominations of the bonds of the issue). An issue or a security that is “discounted two points” is quoted at 98% of its par value.
- premium: The amount by which the price of a security exceeds its principal amount.
- primary market (new-issue market): Market for new issues of municipal bonds and notes.
- private placement: The negotiated offering of new securities directly to investors, without a public underwriting (i.e., a limited distribution).

Vocabulary

- scale: Listing by maturity of the price or yields at which a new issue will be offered.
  - consensus scale—In a negotiated issue, the very early price indications.
  - preliminary scale—Initial prices and yields, before a bid is submitted.
  - final scale—Scale that is submitted to the issuer at the time of the sale.
  - reoffering scale—Scale offered to the investor by the underwriter who has purchased bonds. Also called the winning scale.
- secondary market :Ongoing market for bonds previously offered or sold in the primary market.

Vocabulary

- selling group: A selling group includes dealers or brokers who have been asked to join in the offering of a new issue of securities, but are neither liable for any unsold syndicate balance, nor share in the profits of the overall syndicate. They obtain securities for sale less the take-down.
- senior manager: The underwriter who coordinates the sale of a bond or note issue and manages a syndicate or selling group. A senior manager is usually used only with regard to a negotiated financing. The senior manager will “run the books.” If other securities firms share in the management responsibilities, they may be called co-senior managers, or, to a lesser extent, co-managers.
- syndicate: A group of underwriters formed for the purpose of participating jointly in the initial public offering of a new issue of municipal securities. The terms under which a “syndicate” is formed and operates are typically set forth in an “agreement among underwriters.” One or more underwriters will act as manager of the “syndicate” and one of the managers will act as lead manager and “run the books.” A “syndicate” is also often referred to as an “account” or “underwriting account."

Vocabulary

- take-down: The discount from the list price allowed to a member of an underwriting account on any bonds purchased from the account.
- true interest cost: A method of calculating bids for new issues of municipal securities that takes into consideration the time value of money (see “net interest cost”).
- underwriter: The securities dealer who purchases a bond or note issue from an issuer and resells it to investors. If a syndicate or selling group is formed, the underwriter who coordinates the financing and runs the group is called the senior or lead manager. The difference between the offering price to the public by the underwriter and the purchase price the underwriter pays to the issuer. The underwriter’s expenses and selling costs are usually paid from this amount.

Summary

- Assembling a team
- Structuring the transaction
- Preparing necessary documents
- Obtaining necessary approvals
- Selling the bonds
- Compiling the closing transcript
- Adhering to post-closing obligations

Where to Get More Information

- CDIAC
  - Subsequent programs
  - Debt primer
  - “Debt Line”
- Professional organizations
  - GFOA
  - NFMA
  - CSMO
- Bond Buyer
- Outside professionals
  - Ask questions!

THANK YOU